IMPORTANT NEWS ON GOLD! SEE PAGE 6!

DOW THEORY LETTERS INC.

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Feb. 13, DJIA 958.36; PTI 511; A-D ratio - 22.65
Feb. 20, DJIA 987.80; PTI 533; A-D ratio - 21.77

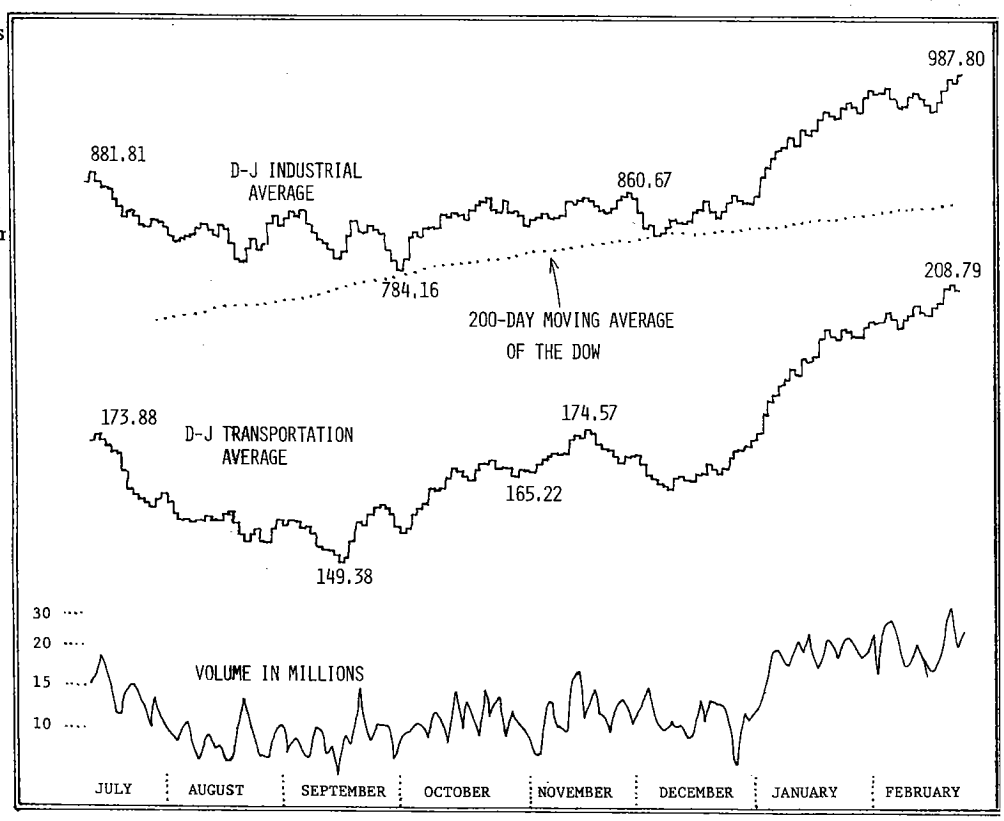
OPENING COMMENTS: I haven't seen a market like this one since the 1950's. In power, breadth, number of groups advancing, most-actives rising, volume, and in simultaneous recordings of new highs in the Averages, the stock market has been absolutely outstanding. Billions of dollars are being added to the market value of the nation's securities as this market works higher. These new billions in market valuation (plus $40 billion in the last month) will be translated into steadily increasing consumer optimism. In time, the situation will turn highly speculative, then totally frothy. But for the time being, the record high volume acts almost like a damper on professional market sentiment. Everywhere, the word "blow off" is heard. In my opinion, we haven't seen the real speculative stage of this bull market. (A sign of change: consumers are now opting for big cars again, while they move away from the austerity-styled compacts).

IT'S A BULL MARKET: Despite the remarkable action of the market since late-1974, I continue to read a good deal (much of it written by intelligent investment advisors) to the effect that this is just "a massive upward correction in a huge, ongoing bear market." Both my studies and my intuition tell me that that just is not true. On February 4, 1975 (Letter 624), following eight years in the bear camp, I wrote that the primary trend was probably in the process of turning bullish. In January, 1975, following the Dow Theory bull signal of January 27, I announced that a primary bull market was in progress. Further, I wrote that the manner of confirmation ("simultaneous penetration by both Averages on record volume") was unbelievably forceful. "Nothing of this kind has been seen in any of the primary bull signals in modern history," I noted.

Events since December, 1974, have justified the verdict of the market. Those who fought or laughed off the bull signal of January 27 have had cause to regret their skepticism. They will undoubtedly have even more cause for regret as the primary bull trend renders their skeptical position increasingly untenable.

The fact is that we are now seeing action different than any we have seen since the 1950's and early 1960's. The most-active stock index (cumulative) is now climbing in true bull market fashion as is the PTI. The various stock averages are plowing ahead, bettering previous peak after previous peak. Margin debt on the NYSE is climbing, as it always does during a primary bull market.

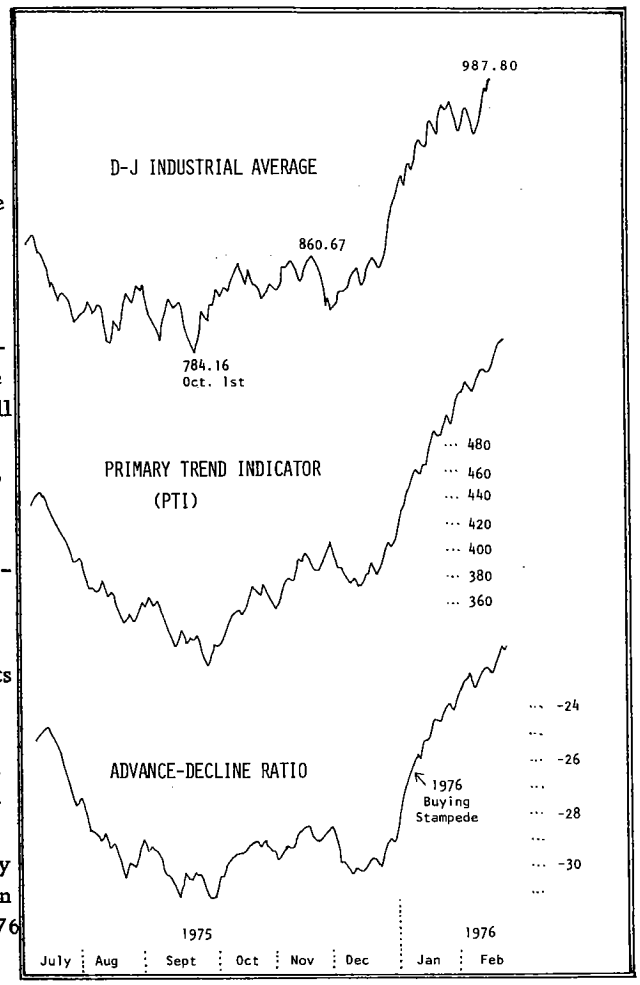
But one of the most important bull market phenomenons has probably gone unnoticed by 99 out of every 100 investors. And that is the bullish year-to-year or long-term action of the advance-decline ratio. Study the chart of the Dow and the A-D ratio as shown on next page (courtesy of Quote Digest). This chart covers nine years of action in the Dow and the A-D. I have marked the important peaks in the A-D for all of the periods since 1968. There were six such peaks during the 1968-74 bear market era, and one major peak appeared during the 1975 bull market period.



Now this is the important part. Since 1968 no peak in the A-D has been bettered by a succeeding peak! In other words, from 1968 to 1974 there was a long, bearish series of declining peaks in the A-D ratio. In 1975 the A-D recorded a July 15 peak, then turned down. In January, 1976, for the first time in nine years, the A-D bettered a preceding major peak, and this is what we see on the chart. That was really bullish action, the kind one sees in a primary bull market. It means that following the first big wave of demand for stocks (characterized by the 1974 to July, 1975 surge in the A-D ratio), a new bullish wave arrived, one which surpassed the first upward wave. Those who are still claiming that this is a rally in a bear market might ponder what this chart is telling us about the character of the 1974-76 market. If this is indeed a bear

 market rally, what would a bull market have to look like?

NEAR-TERM: The Industrial decline from its February 4 peak of 976.62 proved to be a solo performance. While the Dow Industrials dropped to a February 17 low of 950.57, most of the other indicators were heading steadily higher. The Transports dipped for two days following the February 4 peak, then zig-zagged into new high ground for the bull market (see page 1 chart). On February 12 both the Advance-Decline ratio and the Primary Trend Index (chart at right) marched to new highs for the bull market.



Sensing that they were "going the wrong way," Industrials turned violently up on February 17. The banner day of February 20(last Friday) saw the Dow Industrials, the Transports, the A-D ratio and the PTI all at new bull market highs. To add significance to the event, the cumulative most-active stock index (on February 19) finally rose above its July, 1975 peak, and thus on February 20 this index had also rallied into new high ground for the bull market. Just to cap off the whole performance, volume on February 20 surged to an all-time record of 44.5 million shares. The action of the entire week ending February 20 must be labeled as a triumph for "the good guys" (or the bulls, as they are known on Wall Street).

It is worth noting that as of February 20, the A-D ratio was up 8.77 points above its December 9, 1975 low. This equals the 8.80 point buying stampede of December, 1974 to March, 1975. Even if the 1976 buying stampede halts here, it must qualify as one of the great stampedes of the generation. For the benefit of new subscribers, I classify a buying stampede as any advance of 5 points or more in the A-D ratio without an intervening correction of as much as 1 point. Note on the chart at right, by the way, that the 25 point drop in the Dow (February 4 to 17) produced an accompanying A-D drop of only half a point, and this means that the 1976 buying stampede is still in force at the time of this writing).

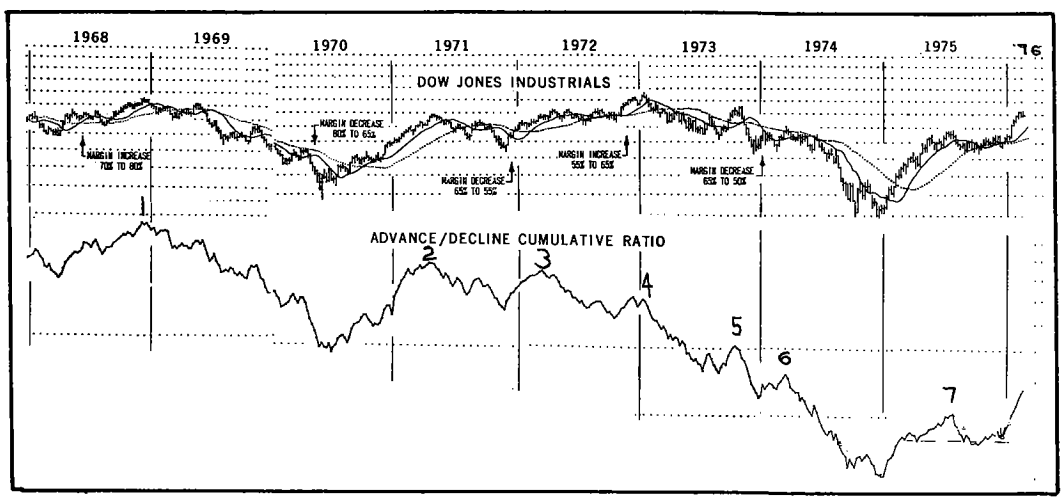
"How far is this explosive bull swing going to carry?" you ask. There isn't a man alive who can provide the answer to that one, but most investors (preferring dim-witted "certainty" to honesty) will cling to a well-publicized guess from any of a hundred self-styled "experts."

I did say in Letter 654 (page 3) that just as the second phase of the 1949-66 bull market took the Dow over the old 1929 record high of 381.17, so the second phase of this bull market could take the Dow over the 1973 record high of 1051.70. I still believe that there is a good chance that the Dow will move above the 1051.70 level before we run into real trouble on this upward swing.

In my experience, market tops do not tend to arrive on record volume, nor do market tops tend to coincide with terminations of buying stampedes. It takes a tremendous amount of pent-up buying power to produce a buying stampede. And history shows that these stampedes usually come in series of two's and even three's. As of this writing, we are still in our first buying stampede of the second phase of the bull market.

We are now in the second psychological phase of the bull market. A phase may contain one or many primary swings. When the ultimate correction of the entire second phase does arrive, I believe it could very closely resemble the kind of action we saw at the end of the second phase back in 1957. That could mean a violent drop of perhaps 20% in the Dow in a matter of a few months.

From the current level, a 20% decline would amount to a drop of around 200 Dow points. Of course, such action would bring anguished cries of "It's the end of the bull market" and "run for the hills." In my opinion, a correction here or in the months ahead would look like a typical second phase decline in that it would be deceptive, frightening and deep. But it would not end the bull market. Parenthetically, so many analysts are now on the "nervous wagon" that I think a 20 to 40 point Dow decline would serve to clear the air.



Wall Street makes money on big volume, it thrives on big volume. But it is also scared to death of big volume. The Street associates record volume with frenzy, a foamy-mouthed public, an invitation to disaster. If a decline here served to calm the market down it would be to everyone's liking and therefore to the bulls' benefit. Occasionally, a bull market gives everyone what they need to make them happy. We could be getting a beneficial "happy pill" in the shape of lower volume now — or even a little shakeout.

ART, MARKETS, ACTING and the SELF. I don't know how many of my readers like art, but I happen to enjoy paintings. Recently, I have been visiting and revisiting an exhibition of post-World War I painting which is on display at a local museum, and I must say that I have been fascinated with this particular exhibit. To my mind, there is something almost unearthly about "a great painting" (of course, I have to like the painting myself, regardless of whether the critics label it as great or not).

For instance, I study a painting by the "Fauve," VanDongen, and I marvel at its originality, its startling colors (the Fauves or "wild beasts" as they were called, were a group of turn-of-the-century artists known for their unrestricted use of color). How could anyone have failed to recognize VanDongen's genius at the time, I wonder? How could they have missed VanDongen, or Vlaminck, or Matisse, or Jawlenski or Puy?

A few hours later I turn to my charts of the stock market. I study the long-term graphs of past bull and bear markets. I must say that in retrospect some of these primary swings look just as beautiful as a VanDongen painting—or at least they look as beautiful in my eyes.

There's something almost uncanny about a bull market that springs from a tiny "turn" on the chart, pushes its way up, then expands as belief gradually spreads in the power of the bull. Finally, the market tops out, usually many years from the first, fragile rise in the Averages. It's an incredible story unfolding. And I think of the agony, the days and months of pondering and waiting, the nagging doubts, the fear as early purchases are made, the mistakes on the way up, the later profits, the untold human dramas that accompany the unfolding bull market. If all the tales that were contained in those lines on my chart could be told, they would fill half the libraries in the world.

It is also well to remember, as we study bull markets of the past, that the direction of the primary trend is usually doubted by a large number of investors—all the way to the final bull market top. By the same token, investors usually "fight" a primary bear market all the way to the ultimate bottom.

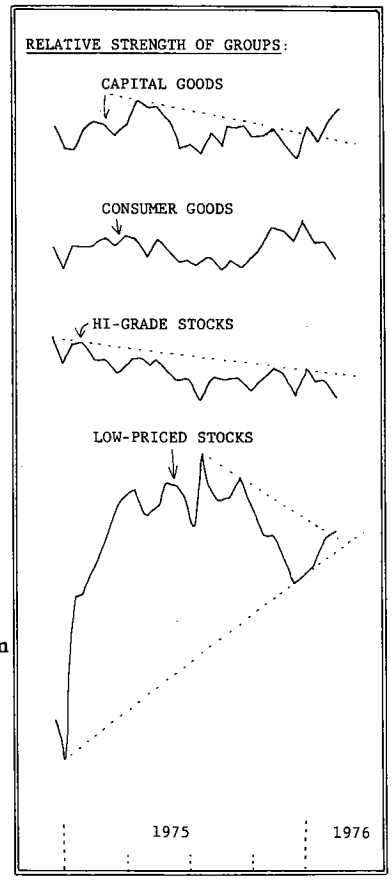
And, of course, that's why it is so interesting to study the bull and bear markets of the past. As we do we ask ourselves, "Why didn't they see this?" "Why didn't they notice that obvious formation?" "Why didn't they understand that the tide had turned?" And the answer is that as students we are all geniuses. As tacticians with theoretical portfolios we all make fortunes. But when we have to put ourselves on the line, when we have to say (as I do) this IS or IS NOT a primary bull or bear market, then it isn't so easy. Reality is always the tough one, and that's why Freud wrote, "Thinking is rehearsing." Thinking and rehearsing are safe, but they don't get the job done. Acting is never safe, but it gets results.

In my observation, one of the greatest deceptions to confront the average individual lies in separating thinking from acting. How many times have you thought something out, even come to a conclusion, and then considered that the job was done — only to find that you hadn't acted? For instance, I thought about quitting smoking for twenty years (I even "quit" for two years), but in the end it was all rehearsing. When I finally acted, the job was done. In retrospect, the twenty years of rehearsing proved to be an utterly futile waste of time.

Along the same lines, how many times have you told yourself that you should have bought some stocks in this bull market? Did you buy any low-priced stocks as per Letters 653, 654 and 655? Did you buy any stocks back in December, 1974? Did you sell out before the late, great bear market wiped you out? Did you get out of the golds before the huge collapse? Or did you simply think and plan and rehearse? Do you understand the difference between thinking and acting as far as you personally are concerned — in both your investment life and in your personal life. Are you stuck, and if so, have you got the courage to act and thus to become free? These are the questions which changed my own life from passive to active.

The fact is that nobody is really passive; we were all born to be active and effective. The passive person is the one who plays it safe, thinks, assumes, rehearses, nurses his anger, his resentment, hangs on. The active person lets go, lets go of his energy, his treasures, his emotions, his money, his preconceived notions. No one really "changes" on this earth. The ONLY possible change is to become more your true self. That usually (don't ask me why) entails giving up one's number one treasure (whatever that may be). But it's worth it to re-own your self. After all, your self is all you can really have anyway. Why not re-own it? I believe that's our chief job here on earth.

RELATIVE STRENGTH IN WHOLE AREAS: In the last Letter I included a section on the relative strength (RS) of the three Dow stock Averages compared with the NYSE Composite Index. In this Letter I am including a study of RS in four larger segments of the market. The four divisions are capital goods stocks, consumer goods stocks, hi-grade or investment grade stocks and low-priced stocks (all these groups are tabulated weekly by Standard & Poor's).



I felt the chart showed a number of interesting developments in RS. First, after lagging the market all during 1975, the year 1976 saw RS in the capital goods stocks turn up on a trend basis. Meanwhile, consumer goods stocks, after a strong second half performance in 1975, have now slid off in RS. I see this as a basically bullish development for both the stock market and the economy. As I've said many times before, business booms are built on expansions in the capital goods segment of the economy, not the consumer segment. The market is now telling us (despite what we hear from the economists) that a major move is coming in capital goods.

Next, note that the hi-grade stocks are moving down in RS. This is as it should be during a bull market. The rate of decline in RS is not very marked, so far, but what the chart is telling us is that there is a gradual but persistent trend in this bull market away from conservatism (i.e., the hi-grade stocks) and towards adventurism and speculation.

The last graph is particularly interesting to me. It shows that in the first half of 1975 there was a huge accumulation period in the very low-priced stocks, and this (despite what you may hear) is typical of the early stages of a bull market. Many shrewd and knowledgeable investors during late 1975 moved part of their money into good quality stocks and part into the $2 to $6 numbers that literally dotted the Board. This buying of collapsed good stocks plus "cheapies" sent RS in the low-priced stocks flying during the first phase of the bull market.

But during the second half of 1975, RS in the L-P issues sagged, and new money tended to move into the better quality issues (and these too were still vastly underpriced). The latest phenomenon (as the Dow nears the 1,000 level) is a rush to accumulate many of the lower priced stocks again, stocks such as the ones I have been listing (under $10) in the last four Letters.

There is no way of knowing for sure, but it would not surprise me to see the mid-1975 peak in Low-Priced stock RS stand until the third or final phase of this primary bull market. When that speculative phase arrives, the public should take the bull by the horns and run the L-P stocks through the proverbial roof. At that time, I would expect RS in the L-P stock index to roar to a new high for this bull market.

In the meantime, I continue to view the current action in the L-P and undervalued issues as accumulation, not (as is so widely held) as a "blow off" in the market fed by ignorant Johnny-come-lately's who are rushing in to gobble up any "cat or dog" they can find.

QUESTION: You recommended buying options a few times last year, but you haven't mentioned them since. Do you still like them, or do you have some objection to options?

ANSWER: I have no real objection to options, although in general there is more money in selling them than in buying them. My main criticism (and really the only one) that I have regarding buying options is that you are fighting time. True, buying options in a "hot bull market" is not the worst thing you can do, but you are always dealing with a cut-off in time. You can buy a three month option on Widget Int., and the stock takes off in four months. You were right on the stock, but a month too late.

I have written that the low-priced stocks that I have been recommending constitute "perpetual options" or calls on this bull market. In other words, you may have bought Addressograph at 9 when I recommended it, and you have now watched it rise 50%. But the real, major move may be a year away, perhaps in 1977. If you held an option in AIN, you might have captured the initial move. But buying the actual stock at 9 and holding it amounts to a perpetual call on the stock. I personally prefer this procedure regardless of the fact that there is more potential leverage in buying the options. But that's the catch, right there. The potential could be eliminated by poor or unlucky timing, and buying the stock itself eliminates the problem of timing in a bull market.

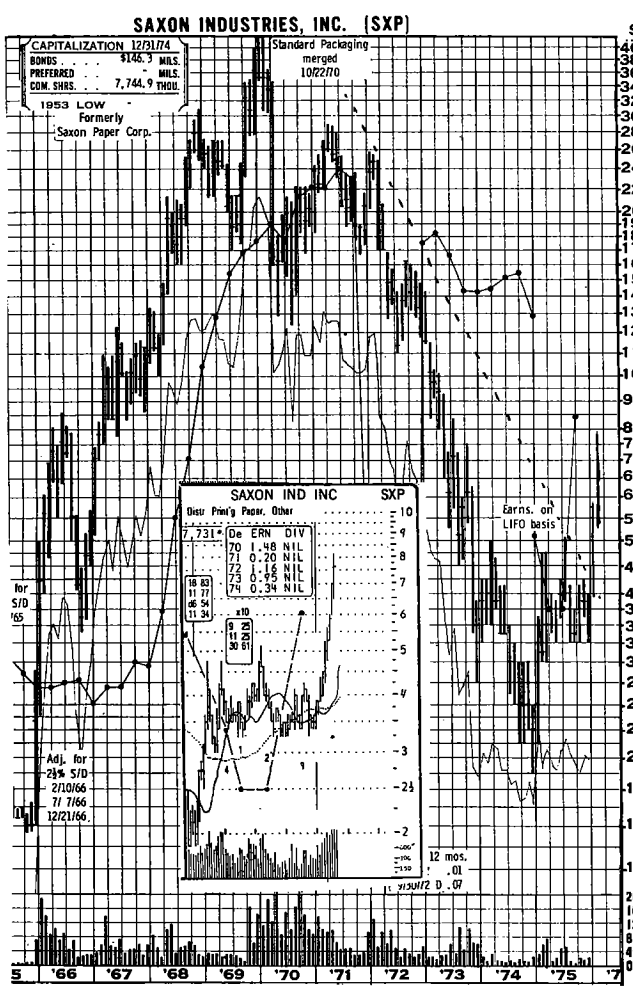
QUESTION: I agree that we're in a new primary bull market, as you have been insisting. But what about all the fundamental problems that were never cleared up in the late bear market that ended in 1974? What was really corrected except the price of stocks themselves? And what do you see coming up after this bull market ends?

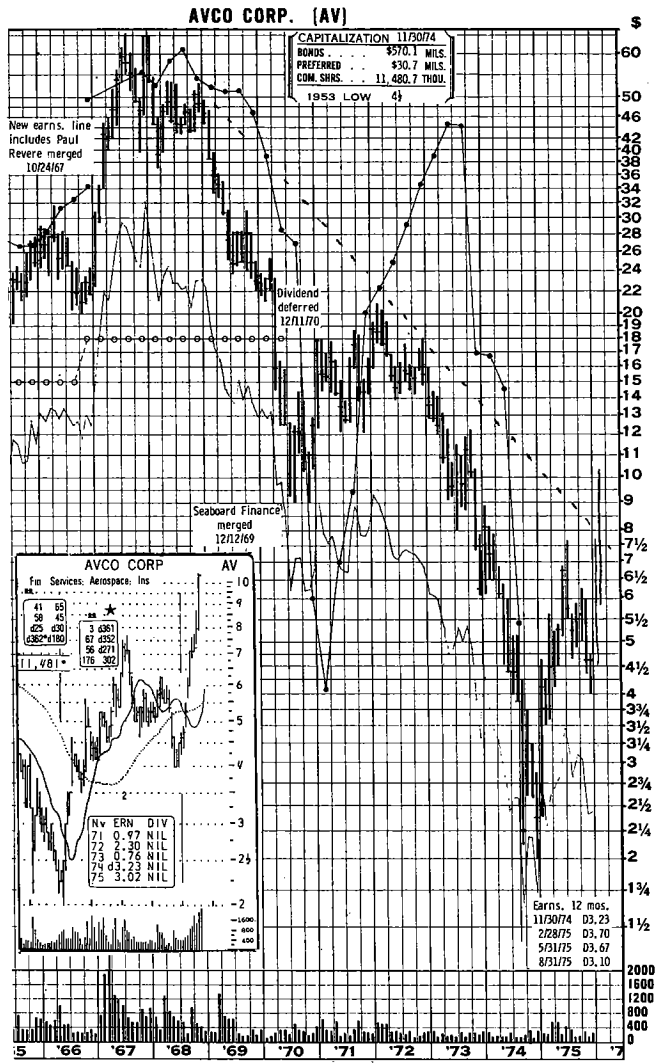
ANSWER: The bear market did do alot of "good" in that it moved banks, S & L's, corporations and the whole real estate segment towards building liquidity. This bull market is "saying" that it's going to get a lot better before it gets bad again. How long the period of improvement will take is anyone's guess, but I note that most analysts are giving this bull market about six months or a year more of life. I'm not at all convinced that the next bear market is fated to begin before the '76 elections or in 1977. When the ultimate bull market top comes, I hope to be able to identify it as I did the 1966 bull top and the 1974 bottom. But to predict when it will come——that's a different story, and my crystal ball is a bit clouded on that count.

I want to remind readers again that the great unknown in this business is always psychology. There are alot of smart guys around who can tell you within a few dollars or so just how much the Dow Industrials will earn this year. And they can even give you very informed guesses about earnings in 1977. But they can't tell you what the market will pay for those earnings. And the P/E's are what really move the market (far more so than the earnings themselves).

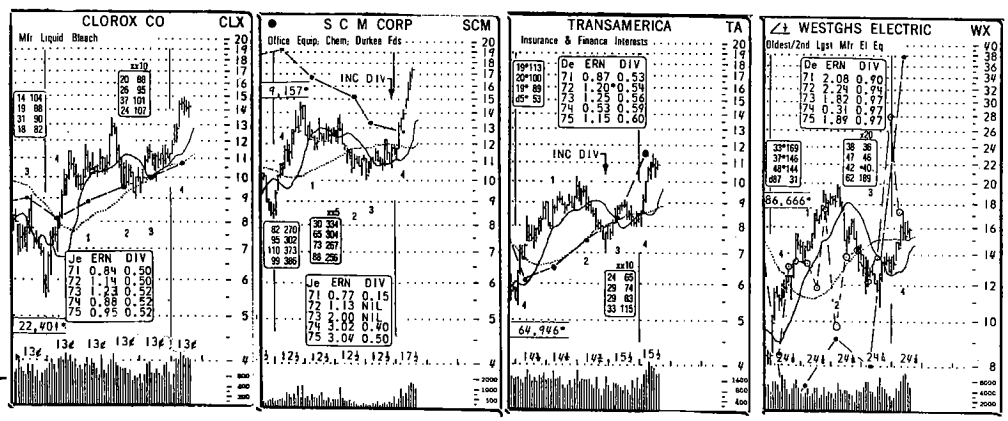
My own feeling is that when this bull market is finally over, we'll be in for a lulu of a bear market, perhaps much deeper and more violent than 1966-74. But my job is to get investors on the right side of the trend, not to keep them obsessed with Armageddon. When this bull tops out and heads down, I will probably be the biggest bear around. At that time, I may be urging all my

subscribers to put a dead bolt on the door, breed Dobermans, bury their gold bars under the floorboards and practice quick-drawing with a 44 magnum. But until then, the primary trend of the market and the economy is up. That being the case, keep your money on the bull side (go ahead, talk "the end of the world," tell your friends that Western civilization is sinking into the sunset, redraw your will, but keep your investments on the bull side of the ledger!).


SAXON INDUSTRIES, INC. (SXP)
CAPITALIZATION 12/31/74
BONDS $145.3 MILS.
PREFERRED - MILS.
COM. SHRS. 7,744.9 THOU.
1953 LOW
Formerly Saxon Paper Corp.
Standard Packaging merged 10/22/70
SAXON IND INC SXP
Earns. on LIFO basis
Adj. for 2½% S/D 2/10/66 7/ 7/66 12/21/66.
12 mos. .01
'66 '67 '68 '69 '70 '71 '72 '73 '74 '75



STOCKS: Since January, I have recommended about 40 different lower priced issues. Almost all of these stocks are now well above the prices at which they were recommended. I must assume that most of my subscribers have good profits in these undervalued situations, because these lower priced values have very literally exploded over the past month. At this juncture, frankly I am hesitant to do much more recommending.



Studying my monthly charts, it is clear to me that a huge number of stocks have completed major bases and have now "popped their heads" well out of those bases. I use Avco and Saxon Industries (both previously recommended) as examples. Note that on the large monthly charts, these stocks have really just broken upside out of beautiful base patterns. Now look at the (smaller) weekly charts which are inserted in the monthlies. Saxon has rocketed from 3½ to 8 and is far above its 200-day moving average (dotted line on small chart). Thus, I could not safely say "buy" here. Avco has run from 4 to over 10 and is now far above its 200-day MA. Thus, I put it in the same category as Saxon.

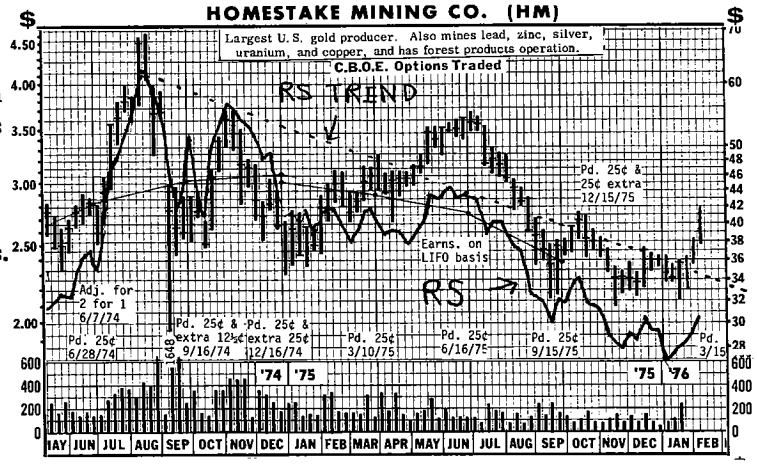
The fact is that both of these stocks could easily correct and in doing so, scare the devil out of today's buyer. But I feel that all the stocks which subscribers purchased should now be held; they should be held in harmony with the primary bull trend until such time as

we have reason to believe that the bull market is in danger of breaking apart. I purposely show the monthly charts to give my readers an idea of how much potential lies ahead for stocks which, on a weekly chart, appear to be blowing their tops. Monthly charts courtesy of Securities Research, 208 Newbury, Boston, Mass 02116. Small weekly charts courtesy of Quote, PO Box 213, Wichita, KA 67201.

In looking over all the recommendations of the past month or so, I feel that the following still offer good value. Transamerica (TA), Westinghouse (WX), Clorox (CLX) and SCM (SCM). Remember, however, that the best buying is always done when you are "sweating profusely," while the least advantageous buying is done when you can't wait to get rid of your money.

I would prefer that subscribers have their stocks in the lockbox now, rather than rushing in for initial positions at this time. But at least we have a great bull trend under us now, and as I've written so often, a bull market ultimately bails out all timing mistakes.

GOLD: I am of the opinion that the bear market in gold bullion and shares has ended. This does not guarantee an immediate gold boom, but it makes it alot easier to purchase gold items. Veteran readers are familiar with my interpretations of the Fibonacci series (3, 5, 8, 13, 21, 34, 55, 89, etc.). Each two numbers add up to the third. Each number is a ratio of 61.8% of its next higher number). From the late-December, 1974 bullion peak of about 200 (intra-day) to the late-January, 1976 low of 123 (intra-day) was 55 weeks. The number 55 is in the Fibonacci series. When 123 is divided by 200 we get approximately 61.8. This is the Fibonacci ratio. The twin figures seem almost beyond coincidence, and it fits in with my study of gold in the last report (Fibonacci figures thanks to reader J. Bridgman of Minn.).


HOMESTAKE MINING CO. (HM)
Largest U.S. gold producer. Also mines lead, zinc, silver, uranium, and copper, and has forest products operation.
C.B.O.E. Options Traded
RS TREND
RS
Earns. on LIFO basis
Adj. for 2 for 1 6/7/74
Pd. 25¢ 6/28/74
Pd. 25¢ & extra 12½¢ 9/16/74
Pd. 25¢ & extra 25¢ 12/16/74
Pd. 25¢ 3/10/75
Pd. 25¢ 6/16/75
Pd. 25¢ 9/15/75
Pd. 25¢ & 25¢ extra 12/15/75
Pd. 3/15
'74
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MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC JAN FEB

At today's price of 133.40, bullion is at a five-week high and remains in a near-term bullish trend. At 147 gold would look increasingly bullish, and at 150 gold would break above an established secondary downtrend and look very bullish.

As I suggested it would, Homestake (HM) has been THE gold stock leader. At today's price of 43-3/4 (Feb. 25), HM has rallied well above its October, 1975 peak (see chart, which is again courtesy of Security Research). Note that HM has not yet reversed its 17-month declining trendline in relative strength (RS). If and when it does reverse that trend, the action will be a big plus for gold shares. In the meantime, the Canadian golds are showing a little life, and the South Africans are roughly on their lows. Watch bellwether Vaal Reefs at the 20 level. If Vaal persistently refuses to break 20, the worst for the Kaffirs should be over. If Vaal breaks 20 (and I kind of doubt it will), then I would guess one more decline would end the trouble for S. African shares.

In the meantime, many subscribers have pilot positions in HM and Amgold (ADR's) as suggested. It wouldn't hurt all subscribers to have some kind of commitment in those two just to have "your feet wet" in case my thesis of a coming bull market in gold happens to be correct (I know that looks almost impossible, here with most gold shares sitting at or near their bear market lows). For those who want to have something in Canada, I would suggest pilot positions in Dome Mines and Camflo. I know all about the objections to Canadian shares and galloping socialism in Canada, but Canadian socialism has probably been discounted by that market.

England, for instance, is also in the Socialist wringer, but look at the British stock market today (it's way up there in case you haven't been watching). Speaking of jolly England, I just heard this description of the average Englishman: "He's five foot nine, he weighs 170, he lives in Bognor, is currently 'on strike' and has the flu." (To my British subscribers, "I was only kidding").

I am asked if we can have a bull market in gold shares and non-gold shares at the same time. I think so. Gold shares could be ready to discount inflation in 1977 or '78, I don't know. But if informed investors sense inflation a year or so away, they won't wait for the New York Times to tell them about it, they'll start accumulating gold shares now. In the meantime, US business is getting better, and a bull market continues in our regular shares.

ITEMS: My old pen-pal Humphrey Neill (of "contrary opinion" fame) has come up with a contrary opinion which interests me very much at this particular time. Writing in Growth Stock Outlook (PO Box 9911, Chevy Chase, MD 20015) he notes that all the economists are in agreement that "Growth is to be moderate, unemployment to decrease only slightly, inflation to drop another percentage point or two." Says Humphrey, "I don't recall a time when I've seen such widespread accord." He then goes on to say that things will either be much better or much worse than the consensus indicates. Concludes Mr. Neill, "I'll cast a vote for better-than-expected in 1976." Readers can place Richard Russell's vote in the same corner.

Eliot Janeway notes that 811 of the 2100 NYSE stocks are money-sensitive. Here are the eye-opening figures. The NYSE lists 586 preferred issues (261 of these are convertible). In addition there are 140 utility stocks, 50 bank stocks, and 35 closed-end bond fund stocks. Janeway feels that a good deal of the steam under the A-D ratio was generated by the declining trend of interest rates. When interest rates harden, Uncle Eliot believes we'll see our first test of the strength of the A-D ratio.

LATE NOTES: There are plenty of sellers here with the Dow just under 1,000. Obviously, the bears are betting the market's going to cross up the optimists and fade out at the "1,000 yard line." From the bullish standpoint, it would be preferable for the market to back off here, give the bears new hopes for a smash, absorb the offerings. But a "rest" or a decline here would not end the bull market, at least in the viewpoint of this writer.

I would like to take two weeks between this Letter and the next. Unless Wall Street creates an emergency, that's what I'm going to do. Next letter will be mailed March 12.